GTE

GTE Service Corporation
1850 M Street, N.W., Suite 1200
Washington, DC 20036
202 463-5200

DOCKET FILE COPY ORIGINAL EX PARTE OR LATE FILED

RECEIVED

MAR 12 1997

Federal Communications Commission
Office of Secretary

March 12, 1997

Mr. William F. Caton, Acting Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

EX PARTE: Access Reform (CC Docket 96-262), Price Caps (CC Docket 94-1), Transport Rate Structure (CC Docket 91-213), Universal Service (CC Docket 96-45)

Dear Mr. Caton:

Today, representatives of GTE Service Corporation, GTE Telephone Operations and NERA met with John Nakahata of the Office of General Counsel and with Jim Schlicting, Chris Barnekov, Aaron Goldschmidt, Steve Spaeth, Brad Wimmer, Paul Glenchur, Katherine Schroder, Rich Lerner, and Mark Seifert of the Common Carrier Bureau to discuss comments submitted by GTE in the above captioned proceeding. The attached were used to augment the discussion.

Please call me if you have any questions.

Sincerely,

W. Scott Randolph

W. Scott Randolph
Director - Regulatory Matters

Attachments

c: John Nakahata
Jim Schlicting
Chris Barnekov
Aaron Goldschmidt
Steve Spaeth
Brad Wimmer
Paul Glenchur
Katherine Schroder
Rich Lerner
Mark Seifert

No. of Copies rec'd 0+5
List ABCDE

MARCH 11, 1997

Presentation of Dr. Michael A. Salinger

Pricing Flexibility in Exchange Access

Outline

I. There must be a general presumption that downward pricing flexibility is beneficial.
   A. Competitors' concerns about competition masquerade as concerns about predation.
      1. It is implausible that any ILEC would try to drive AT&T (to say nothing of Sprint, MCI, and WorldCom) from the market in hope of subsequently raising prices.
   B. If competitors can offer facilities-based service in selected geographic areas or buy unbundled elements on a geographically deaveraged basis, ILECs must be able to lower prices in selected areas.

II. Some immediate upward flexibility is necessary.
   A. Where access prices have intentionally been held below cost, higher prices are economically efficient.
   B. The ILECs must be able to earn an adequate rate of return at least on a forward-going basis.
   C. The Commission will likely be sued if it does not take adequate account of cost recovery; and the end result might be that we will pay for uneconomically low prices now with uneconomically high prices in the future.
   D. An upward pricing band is the appropriate protection against excessive rate hikes.

III. Concerns about price squeezes are not a reason to hold up pricing flexibility.
   A. The legitimate concern with price squeezes is access prices that are too high, not long distance rates that are too low. Regulation and the availability of unbundled elements prevent access prices that are too high.
   B. Uneconomic bypass of the local exchange is at least as serious an issue as uneconomic bypass of long distance networks.
   C. ILECs are at a substantial disadvantage in entering long distance markets since four networks are already in place. This lowers the likelihood that they will try to enter long distance on a facilities basis. To the extent that a price squeeze is an issue, it only concerns the retail margin.

IV. The so-called competitive approach is really a regulatory approach and is not in the spirit of the 1996 Act.
   A. It makes sense to make sure that potential competition exists before easing regulations. The Commission's conditions for potential competition are, however, that regulatory constraints be tightened.

Access Reform

March 1997

GTE Telephone Operations

What did the Telecom Act of 1996 intend to accomplish?

- A pro-competitive telecommunications environment
- A deregulatory telecommunications environment
- The explicit funding of what had been implicit subsidies

What does the FCC want?

- An approach for:
  - addressing claims that existing access charge levels are excessive
  - establishing a transition to access charges that more closely reflect economic costs
  - deregulating ILEC access charges as competition develops

- Two possible ways to get there:
  - prescriptive approach
  - market-based approach

What does GTE want?

- Economically rational pricing
- Pricing flexibility in order to compete
- Opportunity to recover all costs allocated to the interstate jurisdiction
- Competitively neutral recovery of universal service and regulatory policy costs

What is GTE's approach?

- First, remove and adequately fund embedded cost associated with past regulatory decisions
- Second, remove and fund remaining implicit subsidies in access charges in a competitively neutral manner
- Third, provide common line recovery through SLCs and Universal Service Fund
- Fourth, simplify price-cap structure and allow immediate pricing flexibility
- Finally, allow switching and transport rates to reflect economic levels based on market conditions

What is GTE's plan?

- Establish pricing rules for access charges, consistent with goals of competition
  - Removal of implicit subsidies
  - Market flexibility
  - Simplified price cap structure
- Fund to replace implicit subsidies no longer in prices
  - High Cost Fund (new Universal Service Fund)
    - Loop costs not recovered in prices
  - Public Policy Cost Fund
    - Under-depreciated plant resulting from noneconomic depreciation rates
    - Arbitrary allocations to the interstate jurisdiction (until dealt with by new separations rules)
    - Costs not recovered in prices because of regulatory decisions

What is GTE's plan?

- Rational, efficient prices
  - Access services
    - Switching
      - *Volume and term discounts*
      - *Customer-specific pricing*
      - *New services deregulation*
      - *Pricing flexibility / permissive rate structures*
    - Common Line
      - *Associate loop cost with loops*
      - *Geographically deaverage loop costs*
      - *Set SLC price lesser of cost or cap, and recover loop cost in excess of cap from Universal Service Fund*

What is GTE's plan?

- Rational, efficient prices
  - Access services (cont.)
    - Switched Transport
      - *Eliminate arbitrary allocations to the interstate jurisdiction*
      - *Remove from prices caps costs remaining in the TIC after allocating costs to appropriate interstate rate elements*
      - *Price Transport based upon the manner in which costs are incurred*
      - *If cost recovery is not permitted in prices, recover from Public Policy Fund*

What is GTE's plan?

- Productivity factors
  - Estimate achievable productivity gains using a Total Factor Productivity method
  - Recognize impact of competition and changed rate structures on productivity
  - Not to be used as arbitrary tool to force down prices
- Price-cap basket structure overhaul
  - Cumbersome existing system (four baskets, multiple categories, subcategories, zones)
  - Proposed new system:
    - Single basket for not fully competitive services w/ three categories:
      - *Tandem switching and transport*
      - *Local switching*
      - *Database services*

Recovery of embedded costs and implicit subsidies

- Amortize reserve deficiency over 5-year period, allow establishment of economic depreciation rates going forward
  - RDA = $7.1 billion; interstate portion = $1.6 billion
- Reallocate TIC to other elements
  - TIC = $183 million, $101 million of which should be assigned to the Regulatory Policy Fund
- Difference in prescribed below-cost rates and actual costs
- Recovery through bulk-billed regulatory policy charge
  - RDA phased down over 5 years

FCC should avoid residual per-line approaches

- Perpetuates uneconomic bypass, evasion though dial-around
- Discriminatory, disadvantages ILECs by forcing an implicit subsidy
- If adopted, must be applied to unbundled loops
  - Consistent with competitive neutrality principle in 1996 Act
  - Actual costs continue to be allocated to interstate irrespective of how UNE prices are set
  - ILECs must be permitted to recover interstate allocated costs through interstate recovery mechanisms
- Problem would be reduced if UNEs were priced properly, and cost separations is reformed

Pricing flexibility is needed now

- Proposed market-based approach is still a regulatory approach
  - Cannot tie grant of pricing flexibility to compliance with stayed order
  - Cannot attempt to apply Section 271 conditions to independents
- Additional pricing flexibility is needed now to address both real and potential competition
  - Discounts, deaveraging, contract pricing, rapid introduction of new services
- Price-cap basket structure must be simplified
- Safeguards are adequate: constraining effect of UNEs, tariffs, price-cap constraints

Rates to reflect market conditions

- Once subsidies are removed and pricing flexibility is allowed, overall level of switching rates will drop
- UNEs will ultimately dictate the level of switching and transport charges
- FCC's prescriptive approach is inappropriate
  - Skews competition, producing inefficient results
  - TELRIC/TSLRIC are inappropriate for setting access and interconnection prices, and USF costs
- FCC shouldn't mandate different rates for originating & terminating access
- IXCs will benefit from elimination of CCL, removal of other subsidies, adoption of rational pricing

What could go wrong?

- Possible breakdowns
  - Non-competitively neutral funding of subsidies and policy costs will promote some competitors, not competition
  - Failure to recover costs
  - Undersized Universal Service Fund
  -
- Cross-docket inconsistencies
  - Universal service
  - Separations
  - Interconnection

GEOGRAPHICALLY DEAVERAGED LOOP